

**LEGISLATIVE SERVICES AGENCY
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FISCAL IMPACT STATEMENT

LS 6385

BILL NUMBER: SB 76

NOTE PREPARED: Nov 24, 2002

BILL AMENDED:

SUBJECT: Inheritance Tax Exemption for Class A Transferees.

FIRST AUTHOR: Sen. Ford

BILL STATUS: As Introduced

FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill provides an exemption from the Inheritance Tax for property interests transferred to lineal descendants and ancestors (Class A transferees) with respect to persons who die after June 30, 2003.

Effective Date: July 1, 2003.

Summary of Net State Impact: Under the bill, the state will experience a reduction in Inheritance Tax revenue beginning in FY 2005, but will experience a compensating increase in Estate Tax revenue in FY 2005 and FY 2006. In addition, the bill is expected to increase state General Fund expenditures on county Inheritance Tax replacement. The net state impact of the bill is summarized in the table below. (These estimates will be updated as new forecast totals and new tax data become available.)

Fiscal Year	Inheritance Tax Revenues	Estate Tax Revenues	State Expenditures for County Replacement	Net Increase (Decrease)
2005	(\$47.4 M)	\$12.5 M	(\$1.4 - \$4.1 M)	(\$36.3 - \$39.0 M)
2006	(47.4 M)	3.8 M	(1.4 - 4.1 M)	(45.0 - 47.7 M)
2007 and after	(47.4 M)	0.0	(1.4 - 4.1 M)	(48.8 - 51.5 M)

Explanation of State Expenditures: The bill could potentially increase expenditures from the state General Fund for county Inheritance Tax replacement by \$1.4 M to \$4.1 M annually beginning in FY 2005.

Necessary replacement funding could vary within this range depending upon whether, and by how much, each county's base revenue exceeds the amount guaranteed under current statute.. (See *Explanation of Local Revenues*, below, for explanation of county revenue loss and replacement procedure.)

Explanation of State Revenues: The bill is estimated to reduce Inheritance Tax revenue by \$47.4 M annually beginning in FY 2005. However, the reduction in Inheritance Tax liabilities is estimated to increase Indiana Estate Tax revenue by \$12.5 M in FY 2005 and \$3.8 M in FY 2006. Estate Tax revenue is expected to decline to zero beginning in FY 2007 due to the phase-out of the state death tax credit under the federal Estate Tax. Thus, the estimated net revenue loss is \$34.9 M in FY 2005, \$43.6 M in FY 2006, and \$47.4 M beginning in FY 2007.

Background on Inheritance Tax: The bill would completely exempt transfers to Class A transferees from the Inheritance Tax. The change would apply to transfers made by persons who die on or after July 1, 2003. Since the Inheritance Tax does not have to be paid until a maximum of 12 months after the decedent's death (within 9 months of the date of death to receive the 5% early payment discount), the full impact of the bill likely would not be experienced until FY 2005. The estimated impact of this change is based on the Office of Fiscal and Management Analysis (OFMA) Inheritance Tax database and the Revenue Technical Committee's FY 2003 forecast (updated November 14, 2001) for the Inheritance Tax totaling \$140 M. The Inheritance Tax database is comprised of 112,951 records for transferees receiving property from a decedent who died between July 1, 1997, and June 30, 2000. Of the total tax liability for the transferees in the sample, 39.43% is attributable to Class A transferees. The revenue forecast total is a combined amount including both Inheritance Tax and Estate Tax revenue. The five-year (1988-2002) average share of revenue from both taxes that is attributable to the Inheritance Tax is 85.8%. This suggests that the Inheritance Tax will yield about \$120.1 M and the Estate Tax will yield about \$19.9 M in FY 2003. Given the estimated share of revenue from Class A transferees, this suggests that the tax liability attributable to Class A transferees is approximately \$47.4 M. This estimate assumes no change in Inheritance Tax yield through FY 2007.

Background on Estate Tax: Although the bill does not make changes to the Indiana Estate Tax, the reduction in Inheritance Tax liabilities for Class A transferees would affect Estate Tax revenues. Indiana Estate Tax is owed on the assets of an estate if (1) federal Estate Tax is owed on the estate and (2) the Indiana portion of the state death tax credit for federal Estate Tax purposes exceeds the total Inheritance Tax paid by transferees of the estate. Consequently, for some estates a reduction in the Inheritance Tax liability paid by transferees of the estate results in a compensating increase in the Indiana Estate Tax liability. The estimated impact of the bill on Estate Tax revenues is based on OFMA's Estate Tax database and the Revenue Technical Committee's FY 2003 forecast (updated November 14, 2001). The Estate Tax database consists of 559 estates of decedents who died between July 1, 1997, and June 30, 2000, and that paid Indiana Estate Tax. The Inheritance Tax changes provided for in the bill increased the Estate Tax liability of the sample by a factor of approximately 6.7 for FY 2005 and 7.5 for FY 2006. It is estimated that Estate Tax revenue would otherwise total about \$2.2 M in FY 2005 and \$590,000 in FY 2006. This accounts for the phaseout of the Estate Tax in concert with the phaseout of the state death tax credit under the federal Estate Tax. As a result, the Inheritance Tax changes are estimated to increase Estate Tax revenue by roughly \$12.5 M in FY 2005 and \$3.8 M in FY 2006.

Explanation of Local Expenditures:

Explanation of Local Revenues: The bill completely exempts Class A transferees from the Inheritance Tax. The revenue impact of this change coupled with county Inheritance Tax replacement could result in an annual net revenue loss to counties of as much as \$2.7 M beginning in FY 2005. This net impact is

summarized in the table below. (These estimates will be updated as new forecast totals and new tax data become available.)

	Annual Impact Beginning in FY 2005
Inheritance Tax Revenues (Local Share)	(4.1 M)
State Expenditures for County Replacement	1.4 - 4.1 M
Net Increase (Decrease)	(0.0 - 2.7 M)

Currently, counties retain 8% of the Inheritance Tax collected on transfers made by Indiana residents. About 99.1% of Inheritance Tax revenue is derived from the resident Inheritance Tax. Based on the FY 2003 forecast for state Inheritance Tax revenue totaling \$120.1 M, annual county Inheritance Tax revenue is estimated to total about \$10.4 M beginning in FY 2003. Fully exempting Class A transferees would reduce this total by 39.43% or \$4.1 M. It is important to note that a reduction in the amount of Inheritance Tax retained by counties due to the bill may be reimbursed by the state under the replacement provision established by P.L. 254-1997. The replacement provision was established when the Class A exemption was increased on July 1, 1997. The replacement provision guarantees that in each fiscal year each county receives an amount under the Inheritance Tax that is equal to the five-year annual average amount of Inheritance Tax revenue retained by that county from FY 1991 to FY 1997, excluding the highest and lowest year. The maximum amount of county replacement for any year is approximately \$7.5 M. Currently, most counties are retaining more revenue than is guaranteed under this replacement procedure. On average from FY 2000 to FY 2002, counties exceeded their guarantee amounts by about \$3.8 M annually, with annual shortages subject to replacement totaling about \$243,000. With base revenue to the counties totaling \$10.4 M, the revenue loss covered by replacement funds would total about \$1.4 M. Thus, about \$2.7 M in base revenue exceeding the guarantee amount would not be replaced. To the extent that base revenue is less than the estimate, replacement funding would increase and the net loss due to the bill would decline. Thus, county replacement would total \$4.1 M only if base revenue in each county is equal to the guarantee amount.

A copy of a spreadsheet showing the amount of Inheritance Tax replacement guaranteed to each county under P.L. 254-1997 is available from the Office of Fiscal and Management Analysis.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties.

Information Sources: State Revenue Forecast, November 14, 2001. OFMA Inheritance Tax and Estate Tax databases.

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